STATE AND LOCAL TAXATION OF BANKS

Federal legislation at the time of the Civil War placed great restriction upon the freedom of the states in the taxation of national banks and, indirectly, of all banking institutions. As a result, bank taxation has followed lines quite different from taxation of other corporations and now shows more uniformity of method. Serious difficulties still remain. But the point has been reached where agreement upon a satisfactory system seems quite possible. Since this is so, the problem of bank taxation is worthy of special attention.

Banks were among the earliest corporations established, and some of the very first laws providing for special taxes upon corporations apply to banks. The first state law imposing a special tax on banks was passed by Georgia in 1805 and placed a tax of 2½ per cent upon the capital stock of banks and ½ of 1 per cent upon their note circulation. Taxes on the capital stock of banks were imposed by New Jersey in 1810 and by Massachusetts in 1812. Pennsylvania in 1814 introduced a tax based upon the dividends or net profits of banks at the rate of 6 per cent, raised in 1824 to 8 per cent. Other states followed with special methods of taxing banks, the most popular one being the tax upon capital stock, only a few states using the tax on dividends. Most of the states still clung to the old-fashioned general property tax upon all the property of the banks. This was the situation down to the middle of the nineteenth century.[1] The whole course of events was then changed by the legislation of the Civil War.

In 1862 Congress established the national banking system and in the act of 1864 provided for certain federal taxes on national banks, which were to be in lieu of all existing taxes upon such banks.[2] The act goes on to specify, however, that the shares of stock in national banks may be taxed as personal property of the owners under the authority of the states in which the banks are located.[3] This provision has remained in force until the present day with only slight changes. The state legislatures are at liberty to determine the method of taxing the shares of national banks subject only to two restrictions; namely, that the taxation must not be at a higher rate than is imposed upon other moneyed capi-

[1] *Cf.* Seligman, *Essays in Taxation* (eighth ed.), pp. 151-161.

[2] U. S. Revised Statutes, sec. 5214.

[3] *Ibid.*, sec. 5219.

tal, and that the shares owned by persons residing outside the state must be taxed only at the place where the bank is located. The real estate belonging to national banks is also expressly subject to state and local taxation the same as other real estate.

This legislation has had a profound effect upon the history of bank taxation. In the absence of such a law it is likely that the taxation of banks would today present the same diversity and confusion as is seen in the taxation of other kinds of corporations. Under the influence of this law, however, there is greater uniformity today in the taxation of banks than in any other class of corporations.

The federal statute regarding the taxation of banks has been frequently interpreted by the courts, until at the present time there can be little question as to its exact meaning.[4] The term "other moneyed capital" has been so interpreted as greatly to restrict its meaning. It has been held to include only other taxable moneyed capital.[5] The fact that certain moneyed capital is entirely exempt from taxation will not stand in the way of the taxation of capital invested in national banks. Furthermore, it has been held that the term is restricted to capital competing with national banks.[6] Under the New York statute it was held that trust companies were not competitors of national banks.[7] This appears to be scarcely a tenable position, however, and there is reason to believe that it might be altered.[8] The courts have

[4] For a valuable digest of the decisions down to 1906, *cf. Report of the Commission on Revenue and Taxation of California, 1906,* pp. 230-235. The list of references in the California report is so full that reference is made in this article only to a few of the leading cases prior to 1906. *Cf.* also Judson, *The Power of Taxation,* ch. IX, Taxation of National Banks.

[5] *Van Allen* v. *Assessors,* 3 Wall. 573; *People* v. *Commissioners,* 4 Wall, 244.

[6] *Mercantile National Bank* v. *New York,* 121 U. S. 138, and numerous later decisions. *Cf.* California report, *op. cit.*

[7] *Jenkins* v. *Neff,* 186 U. S. 230.

[8] Under the New York law, trust companies are now taxed by exactly the same method as national and state banks except that the tax is assessed to the trust company by the state instead of to the individual shareholders. See the description of the New York law below. The question is therefore no longer of practical importance. There is reason to believe, however, that if the state law should seek to make a clear discrimination in favor of trust companies the present attitude of the Supreme Court might be modified. In the decision of a recent case (*People of New York ex. rel. Amoskeag Savings Bank* v. *Purdy,* 231 U. S. 373), the court referred to trust company stock in such a way as to imply that it was "other moneyed capital" in the sense of the federal statute. The point was not material to the issue in this case, however.

clearly held that savings banks and building and loan associations are not to be regarded as competitors of national banks;[9] special favors to such institutions therefore will not invalidate the taxation of national banks. The term, in brief, seems to include practically only capital invested in the stock of other commercial banks and (probably) trust companies, and money in the hands of individuals employed in a manner similar to the employment of bank capital. The restriction that the taxation of national bank stock shall not be at a greater rate than that of other moneyed capital has been held to apply not only to the tax rate but to the assessment as well.[10] In other words, equality in tax burden is required. The decisions have also made clear that no property belonging to national banks may be taxed except real estate.[11] It has also been held that, even though the taxation of real estate together with the taxation of the total value of the shares of stock involves double taxation, this is no violation of the statute.[12] It is possible, therefore, to tax the entire value of all the capital stock of a national bank and in addition impose a tax upon its real estate, provided only that the same method is applied to other forms of moneyed capital. No deduction need be made from the valuation of the shares on account of investment of the capital in property either elsewhere taxed[13] or exempt from taxation, as United States bonds.[14] The law permits the state to require the bank to pay the entire tax upon its shares of stock.[15] This does not make it a tax upon the bank; the bank is assumed to be acting as the agent of the stockholders and has reserved the express right of charging the tax against each stockholder with a lien upon the dividends and shares of stock as security.[16]

The result has been that the states are practically restricted to

[9] *Davenport Bank* v. *Davenport Board of Equalization,* 123 U. S. 83; *National Bank of Redemption* v. *Boston,* 125 U. S. 60; *Mercantile National Bank of Cleveland* v. *Hubbard,* 98 Fed. Rep. 465.

[10] *People of New York* v. *Weaver,* 100 U. S. 539.

[11] *Rosenblatt* v. *Johnston,* 104 U. S. 462.

[12] *Peoples National Bank of Lynchburg* v. *Marye,* 107 Fed. Rep. 570.

[13] *Pacific National Bank of Tacoma* v. *Pierce Co.,* 20 Wash. 675.

[14] *Mercantile National Bank* v. *New York,* 121 U. S. 138; *Home Savings Bank* v. *Des Moines,* 205 U. S. 503; *Hager* v. *American National Bank,* 159 Fed. Rep. 396.

[15] *First National Bank* v. *Kentucky,* 9 Wall 353; *Merchants and Manufacturers National Bank* v. *Penn.,* 167 U. S. 461.

[16] *Merchants and Manufacturers National Bank* v. *Penn.,* 167 U. S. 461; *Home Savings Bank* v. *Des Moines,* 205 U. S. 503.

one method in the taxation of national banks. Moreover the requirement that there shall be no discrimination against the stock of national banks as compared with other moneyed capital has been so strictly interpreted as virtually (though not expressly) to mean that this method of taxing national banks is legal only in case other banks are taxed in practically the same way.[17] As a result, the method prescribed by federal law for the taxation of national banks has generally been extended by the states to other banking institutions. The old-fashioned taxation of banks on their property under the general property tax has been practically abandoned. Banks are today not generally taxed at all except upon their real estate, which is taxed locally like other real estate, while the shares of stock in banks are taxed as personal property of the owners in conformity with the federal statute relating to the taxation of national banks.

It must not be concluded that the problem of the taxation of banks has been solved. There still remains opportunity for diversity in matters of detail, with serious inequality and injustice resulting. The various methods of taxing bank shares may be conveniently grouped into two classes. (1) Bank shares are taxed by local officers as part of the general property tax. The value of the shares is assessed by local officers and the tax rate is the local rate of the general property tax. (2) The taxation is under a uniform method prescribed by state law. The assessment is uniform throughout the state and usually determined by a state officer or board. The rate also is generally uniform, though it is not always so, and several methods of determining it are in use.

In the majority of the states, taxation of bank shares is still a matter of local administration. The local assessor determines the value of the shares just as he assesses other property under the general property tax. The assessment is relatively easy, since the banks may be required to furnish the necessary facts, including a list of stockholders with their residences and the number of shares held by each. Nevertheless the assessment is practically at the personal discretion of the assessor, and a confusing variety of rules and methods has resulted.

In most states the law requires that all property be assessed at its full cash value. In seeking to arrive at this value some assessors try to determine the market value of shares from available records of sales. In other cases the book value is taken; that is,

[17] *Cf.* California report, *op. cit.*, p. 229.

the sum of capital, surplus, and undivided profits. Some assessors take capital only, paying no attention to surplus and undivided profits. In Colorado the state tax commission recently undertook to fix the value of bank shares by taking capital, surplus, average undivided profits for the year, and 4 per cent of the total deposits. A Wyoming law of 1913 provides that bank shares shall be assessed on their par value plus the surplus and undivided profits in excess of 50 per cent of the capital. In North Dakota banks are assessed on the capital, surplus, and undivided profits, less an amount equal to 5 per cent of the loans and discounts, on the theory that banks may fairly be allowed to assume such a shrinkage in their assets.[18]

To add to the confusion, the values thus determined are frequently reduced by a certain percentage in recognition of the prevailing under-assessment of other kinds of property. The basis of assessment varies all the way from 100 per cent down to 25 per cent or less. In most cases the value of the shares of stock is reduced by deducting the value of real estate assessed to the bank.

Without going into further details, it is clear that inequality and injustice must result from this method of taxation. The greatest inequality between banks, even in the same state, is an inevitable result. For example, it is reported that in Kentucky the state board of assessment values bank stock at 80 per cent of the capital, surplus, and undivided profits, but local assessment in each of the 120 counties is at the personal discretion of the county assessor, with the result that assessment is anywhere from 60 per cent up to 100 per cent of the capital, surplus, and undivided profits. In addition there are city assessors, so that cases are on record of a bank assessed at 80 per cent of its book value for state purposes, 70 per cent for county purposes, and 100 per cent for city purposes.[19] A study of bank assessment in Montana indicated that for the year 1912 assessments in various counties

[18] For complete details the student must consult the statutes of the several states. For brief summaries of the tax systems of all the states, *cf.* U. S. Census, *Wealth, Debt, and Taxation, 1913,* vol. I. Much useful information is contained in the reports of state tax commissioners, boards of equalization, bank commissioners, etc. *Cf.* also numerous articles in *Proceedings of the National Tax Association,* especially Paton, "State taxation of banks," vol. VII, pp. 315-341, and "Report of committee on taxation of banks and financial institutions," vol. V, pp. 313-324.

[19] Paton, *op. cit.,* pp. 329-330.

varied from 18 per cent to 77 per cent.[20] The inequality caused by unequal assessment is of course intensified by the variety of local tax rates.

A comparison between bank stock and other kinds of property, shows an injustice perhaps even more flagrant. With the information at his disposal it is an easy matter for the assessor to arrive at the full value of bank stock. Evasion and under-assessment are practically impossible except with the consent of the assessor. In the case of other kinds of property evasion and under-assessment are the rule. Even where some attempt is made to scale down the value of bank stock, the process is seldom if ever carried far enough to produce justice. Cases have been reported in Illinois of banks assessed on their full book value and farm lands at 20 per cent. An inquiry made in Missouri in 1911 showed instances of bank stock assessed two or three times as heavily as other forms of property. In some counties live-stock was assessed as low as 15 per cent, merchandise 20 per cent, real estate 10 per cent, but in only one county was bank stock assessed at less than 50 per cent. It is said that in some counties of Minnesota 60 per cent of the entire personal property tax is paid by banks and that in some of the cities of Wisconsin banks pay from 15 to 30 per cent of the total personal property tax. At one time the board of equalization of New Mexico officially recommended to the county assessors that all property be returned at actual cash value and that the assessment be 50 per cent of this valuation for bank stock and 35 per cent for real estate and personal property. It is claimed that in North Carolina real estate is valued at from one tenth to one half of its actual value, whereas bank stock is frequently assessed at a higher value than that at which it could be sold. In North Dakota it is reported that real estate and personal property are assessed at from 15 to 25 per cent of their value, while bank stock is assessed all the way from 25 to 70 per cent, according to the personal inclination of the county officials.[21]

There can be no doubt that as a general rule the assessment of bank stock is very much nearer actual value than that of other personal property or even real estate. Since bank stock must bear the regular rate of the general property tax, it is obvious that it bears an unjust burden of taxation. That local taxation of bank

[20] *Ibid.*, p. 332.

[21] For further details of these and similar instances, *cf.* Paton, *op. cit.*

stock is flagrantly unjust as between different banks and as between bank stock and other kinds of property can not be questioned. This method might be dismissed with summary condemnation were it not for the fact that it is the method actually employed in many states and that attempts to remedy its injustice are being made which deserve critical analysis.

The remedy nearest at hand is obviously to require the assessor to scale down the value of bank stock so as to make it correspond with the prevailing under-assessment of other kinds of wealth. We have seen that assessors have sought to secure some measure of justice in this way. In many states the bankers have offered this as their suggestion for reform. The bankers of Indiana expressed themselves as fairly well satisfied when a uniform rule of assessing bank stock at 75 per cent of the capital, surplus, and undivided profits was adopted. Likewise in Iowa the bankers appeared to be fairly content with a rule of 20 per cent of actual value. In Missouri a committee of bankers has devoted itself to urging the state board of equalization and the various county boards to reduce the basis of assessment upon bank capital and has succeeded in obtaining slight reductions. In Kentucky the bankers succeeded in persuading the state board of equalization to cut the assessment of bank shares down to 80 per cent of capital, surplus, and undivided profits. In Nevada the state bankers' association presented the argument that "undivided profits can not be considered a fixed investment, but rather a fund to meet expenses and such losses as the bank may sustain in the conduct of its business, and that to a certain extent the surplus fund should be considered in like manner." As a result the state tax commission agreed to eliminate undivided profits and assess only 75 per cent of the surplus. The economist will feel more sympathy with the result than with the argument by which it was obtained.[22]

There is little reason to hope that justice will be secured through the attempt to scale down the assessment of bank stock. The most that can be expected from this remedy is a palliation of the evil. The principal reason why bank shares are assessed at their true value is that it is so easy to ascertain the true value. Other property is often under-assessed on account of the difficulty of knowing what its value actually is. In most states the law positively requires the assessment of all property at its full value. Although much property is not actually so assessed, the under-

[22] For further details regarding these and other examples, *cf.* Paton, *op. cit.*

assessment is done more or less furtively and is not openly admitted. In the case of bank stock, however, it is practically impossible to put in any value except the real one without openly admitting an intentional under-assessment.

Some states, it is true, have seen this difficulty and have recognized in their statutes the prevailing under-assessment and required that bank shares be entered at values corresponding to the assessment of other kinds of wealth. In other states the same result has been accomplished by administrative action of tax commissioners or boards of equalization, and of course the local assessors exercise some discretion in the same way. Examples have been given above. In none of these cases, however, is more than a compromise probable. Neither by statute nor by administrative discretion is it likely that the full extent of prevailing under-assessment will be openly recognized. The result is to decrease somewhat the injustice against the banks, but not to remove it.

Justice might be obtained by the opposite process; namely, by raising the assessment of other kinds of property up to full value, a process which would, of course, soon be followed by a lowering of tax rates. This result would be eminently desirable from every point of view. That it is likely ever to be generally accomplished is open to grave doubt. The whole history of the general property tax has shown overwhelming forces leading to under-assessment of property. If these motives could be counteracted and all property actually assessed at its full value, one of the greatest difficulties of the tax would be removed. Under the American general property tax in anything like its present form the motives for under-assessment are likely to remain too strong.

In short, the difficulties in the taxation of bank stock under local administration are inherent in the general property tax itself, and attempts to bring relief by securing under-assessment of bank stock or full value assessment of other kinds of wealth are bound to be futile, being able at the best to accomplish only a slight palliation of the present injustice.

We have now to consider the taxation of bank stock under methods prescribed by state laws which require uniformity throughout the state. Here the administration is generally in the hands of state officers, although the returns may be distributed either to the towns of residence of the stockholders or to the towns where the several banks are located, or kept by the state. The two important problems here are the basis of assessment and the rate.

Of the various methods of valuing bank shares two are of special importance and deserve our careful examination. Shares of stock in banks may be valued for purposes of taxation either at their market value or at their book value. Under the theory of the general property tax, market value is apparently the logical basis. Our local tax systems are still founded upon the general property tax. The problem is to bring the method of taxing bank shares into the greatest possible harmony with the present taxation of other kinds of wealth. The general property tax assumes that all kinds of taxable property will be assessed at their true or actual value, which is practically synonymous with market value. Justice would therefore seem to require that bank stock be assessed at its market value.

The objections to market value as a basis for assessing bank stock are of a practical nature and arise from the difficulty of finding out what actually is the market value of the shares. There are, of course, many large city banks whose shares are regularly dealt in on the market. The market value is then a matter of public knowledge and there is no difficulty in determining it for purposes of taxation. However, this is the exception rather than the rule. Most bank shares are not regularly bought and sold. Many banks are owned by small groups of men, and the stock is rarely exchanged. When sold it is apt to be by private arrangement between members of the inside group on terms which are not known to outsiders and which even if known might not fairly represent the actual value of the stock. The sales of stock of small local banks are so infrequent as to furnish no reliable indication of the value of the stock. The law requiring an assessment of the market value of stock imposes a very difficult burden upon the officer charged with the duty of assessment. In the majority of cases he is unable to find any quotation of actual market values and is forced to rely upon reports of brokers or statements furnished by the officers of the banks themselves. Ordinarily he has to estimate a fair market value from examination of the balance sheets and earnings of the banks. This introduces the element of personal judgment and is a fruitful cause of argument and dispute with the representatives of the banks, all of which leads to friction, hard feeling, and inefficient assessment.

The argument is sometimes urged that market value, even when discovered, does not always represent the real value of the stock. Stock values are subject to fluctuations upon the market. These

fluctuations may in general be assumed to represent changes in the condition of the bank and therefore in the real value of the shares, but they may also be caused by circumstances entirely foreign to the bank's condition, such as the situation of the money market, etc. It is also held that shares of stock in banks are often sold at prices far above their real value, due to sentimental reasons. There is great danger of exaggerating the importance of these objections, but such weight as they have simply strengthens the case against the use of market value. The real objection to market value, however, is the difficulty of determining it, and it is this consideration which furnishes the principal argument in favor of the assessment of bank stock at its book value.

Book value is a definite fact, easily determined from the balance sheet of any bank. The value of a share may ordinarily be determined by adding the capital, surplus, and undivided profits and dividing by the number of shares. This method of valuing bank shares does away with the difficulties inherent in the market value basis. In the place of uncertainty, dispute, and guess work, it substitutes a certain method, easy of administration. The book value is a definite thing, shown at any time by the balance sheet of the bank, and the room for argument or difference of opinion is reduced to a minimum. The book value is not subject to frequent fluctuations due to the condition of the money market or other external causes.

Certain objections have been raised to the use of book value as a basis of assessing shares of bank stock. In the first place, it is claimed that market value is the only true value, that all other values are more or less arbitrary, and that the real value of anything is the amount a purchaser is willing to pay for it. There is considerable truth in this contention, and it might furnish a valid case against the use of book value were it not for the impossibility of determining market value, already demonstrated.

The question remains whether book value does actually represent the true value of stock or whether it is arbitrary and subject to manipulation. In particular, it is charged that by changing the valuations set upon its assets a bank may make its book value what it pleases. The officers of the bank may write off certain assets and put others in at lower figures so as materially to reduce the book value and evade taxation. While this procedure is of course open to the officers of any bank, it does not appear likely that it would often be availed of to escape taxation. The motives

leading the ordinary bank officer to make as good a statement as he can of his bank's condition will generally be strong enough to prevent the scaling down of book value below the real value of assets merely to save a few dollars in taxation. On the other hand, if the use of book value should lead some banks to write off doubtful assets or reduce assets previously carried at inflated figures, the result would certainly be a desirable one and would not lead to any real evasion of taxes.[23]

The only methods of assessment deserving serious consideration are the two that have just been discussed. Certain states have adopted methods departing more or less from these two, but usually with unfortunate results. New Jersey, for example, formerly determined the value by deducting from capital, surplus, and undivided profits the assessed value of real estate and the book value of all non-taxable securities owned by the bank. The latter provision allowed a very great reduction from book value, and many banks were able to show non-taxable securities equal to their total capital, surplus, and undivided profits, so that they paid no tax at all except upon their real estate. In a number of cases banks have been actually ashamed to get off so easily and have permitted an assessment and paid taxes which they knew were not enforceable.[24] The somewhat similar experience of California is referred to below. As has been shown, the federal statute does not require the deduction of tax-exempt property or even of property which is elsewhere taxed. There is no reason why such deduction should be allowed.

Some states having assessed the stock at market or book value then proceed to scale the assessment down to a certain percentage. For example, under the Ohio law the state board of equalization assesses the book value and then fixes the assessment at 60 per cent.[25] Something of this sort is a necessity for the sake of justice if bank stock is to be taxed at the same rate as other property. A more effective way of securing justice, however, is

[23] Regarding the relative merits of book value and market value, *cf. Proceedings of the National Tax Association,* vol. IV, pp. 391-401; *Report of the Commission on Revenue and Taxation of California,* 1906, pp. 244-247; *Report of the Connecticut Commission on Taxation of Certain Corporations,* 1913, pp. 130-135.

[24] *Cf. Report of the New Jersey Board of Equalization of Taxes,* 1910, pp. 19-21, and 1911, pp. 21-22; also *Proceedings of the National Tax Association,* vol. VII, pp. 318-319, 340-341.

[25] *Report of the Ohio Tax Commission,* 1908, p. 12.

to make allowance for this in a uniform rate fixed by law. This brings us to the matter of the rate.

There are three ways of determining the rate of the tax on bank shares. First, to impose upon each bank the local rate of the general property tax in the town where it is located. Second, to impose upon the banks a uniform rate equal to the average of the local rates of the general property tax throughout the state. Third, the law itself may prescribe a uniform rate to be imposed upon all banks.

The first method leaves many of the evil results of local administration unremedied, although assessment may be just and uniform throughout the state. The actual burden of taxation will be unequal on account of different local rates. In particular, bank stock, being assessed at practically its full value, will be subject to an excessive tax as compared with other property. The only way to correct this is to make the assessment a certain fraction of the actual value, as is done in Ohio. This can not secure justice for two reasons. It is practically certain that the reduction will not be enough to offset the prevailing under-assessment of other property, and even if this were done on the average, there would remain injustice on account of the varying degree of under-assessment in the different localities.

If instead of a tax on each bank at the local rate there is imposed upon all banks a tax at a uniform rate equal to the average of the general property tax, uniformity is secured for all banks throughout the state. There still remains, however, the excessive burden upon bank stock as compared with other kinds of property, unless this is met by reduced assessment of bank stock to meet the prevailing under-assessment of property. In theory this would be a possibility, but practically there is little reason to expect a reduction sufficient to secure justice.

The only effective way of securing uniformity and at the same time equality as between bank stock and other kinds of wealth is to fix a definite rate low enough to make the tax paid by the owners of bank shares fairly correspond to the burden of taxation placed upon other kinds of wealth. Investigation of this matter has generally led to the conclusion that 1 per cent is a reasonable rate. This is the rate in New York and Connecticut. The California rate was originally made 1 per cent in 1911, but was raised to 1.2 per cent in 1915. The New Jersey rate is ¾ of 1 per cent. Pennsylvania gives the banks the choice between a rate of 4 mills upon

book value and 10 mills upon par value of stock. The 4 mill rate is extremely low, and there appears to be no justification for the alternative 10 mill rate, whose chief effect is to cause injustice between large and small banks.[26]

In addition to the taxation of shares of stock, real estate owned by banks may lawfully be taxed and generally is so taxed. There appears no good reason why local taxation of bank real estate should not continue. It is probably also reasonable to leave the taxation of real estate in the hands of the local officers rather than to attempt to secure any uniform assessment or uniform rate throughout the state.

It is obvious that if the shares of stock are taxed at their full value by a rate which equalizes the burden with that borne by other kinds of wealth, and at the same time local taxation of real estate is allowed, double taxation results. As has been shown, such double taxation is not repugnant to the federal statute. New York expressly permits it and there is little complaint. In strict justice, however, some allowance should be made. Three methods are possible.

First, allow the bank to deduct from the tax paid upon its shares of stock the amount of local taxes paid upon real estate. This is the Connecticut method. It makes the tax on shares of stock measure the total burden of taxation. It produces justice so far as the shareowners are concerned. A difficulty remains, however, in that the banker loses all interest in the assessment and taxation of his real estate, and the door is opened for excessive assessment of such real estate without any protest on the part of the banker, as a result of which the local government may secure more revenue than it is entitled to at the expense of the state revenue.[27]

A second method is to deduct from the valuation of shares of bank stock the assessed value of real estate, as is done in California. This accomplishes practically the same result as the first method. To a certain extent it is open to the same objection, although there is here some motive leading the banker to see that his real estate is not over-assessed. The local tax rate will normally be higher than the rate fixed for the tax upon bank shares. A banker, therefore, loses more through an excessive valuation of

[26] *Proceedings of the National Tax Association,* vol. VI, p. 159.

[27] *Cf. Report of the Connecticut Commission on Taxation of Certain Corporations,* 1913, pp. 134-135, 174.

his real estate than he can gain by having that valuation deducted from the assessed value of the shares of stock. To this extent only will he be induced to use his influence against over-assessment of his real estate. There still remains to some degree the same opportunity for the towns to profit at the expense of the state.

The third method is to allow the unrestricted local taxation of real estate without deduction either from the amount of the tax or the assessed value of the shares of stock, but to make the correction by taking the real estate tax into account when determining the rate of the tax upon the stock. It is easy to find the total amount of taxes paid by banks upon their real estate and to make a corresponding reduction in the uniform rate fixed for the tax upon bank shares. This is doubtless the best method. It protects the state revenue, it leaves each banker to safeguard his own interests as against the local assessors, and on the average it places a just burden of taxation upon the owners of bank stock. It may be objected that while the average burden is just, injustice may be done in the case of certain bankers with large holdings of real estate. This objection need not be given much consideration. The ordinary commercial bank should not invest largely in real estate. If a bank does so, it adopts the course because it sees some advantage in it, in which case it should be able to bear the tax burden necessarily involved.

The foregoing analysis would seem to demonstrate that satisfactory results in the state and local taxation of banks are possible under a method whose main features may be briefly summarized as follows.

A uniform tax is prescribed by state law. The tax is upon the book value of the shares of stock, which is obtained by adding together the capital, surplus, and undivided profits and dividing by the number of shares. No deduction need be made on account of property exempt from taxation or elsewhere taxed, with the possible exception of real estate. The rate of the tax is uniform throughout the state and definitely fixed in the law. The exact rate is a detail to be determined according to the circumstances in the given state. It appears that in general 1 per cent is a fair rate. Administration is preferably in the hands of state officers, although satisfactory results are obtainable under local administration. The tax is collected from the bank, acting as agent of the stockholders. The proceeds may go into the state treasury, or be distributed to the towns or counties according to

the locality of the banks or the residence of the shareholders. Real estate belonging to banks is subject to local taxation like other real estate. Allowance for the local tax on real estate may be made in either of the three following ways, stated in the order of preference: (1) by a slight reduction in the rate of the tax upon shares, (2) by deducting the assessed value of real estate from the book value of the shares, or (3) by a deduction of the tax paid on real estate from the amount of the tax on shares. Of course the shares of stock are exempt from taxation in the hands of the owners.

This method, if applied to all commercial banks and trust companies, is in harmony with the federal statute, is certain and effective in administration, and should give substantial justice to all concerned. Some of the states have already approached very close to the method here indicated and others are tending that way. A glance at a few examples will be worth while.

The state of New York furnishes the best example of the method which has been recommended. The present law was enacted in 1901. Previous to that time bank shares were assessed locally. There was no fixed rule for their taxation, which was left to the judgment of the local assessors. An investigation made in 1899 by Mr. Charles Adsit, president of the New York Bankers' Association, showed that the assessment in different parts of the state varied all the way from 10 per cent to 119 per cent of the capital, surplus, and undivided profits. It was also shown that banks were discriminated against as compared with trust companies, the average rate of taxation upon banks being about five times as great as that upon trust companies. Another result was that shares of bank stock were very unjustly burdened as compared with other kinds of personal property. In one city of 13,000 people the banks, with capital of $250,000, paid three fourths of the total personal property tax, although more than one individual residing in the city owned more than the combined capitals of the banks and yet escaped personal taxation entirely.[28]

The essential features of New York's present system of taxation are as follows:[29] Each bank must report annually to the assessors of the tax district in which it is located, giving a list of its stockholders, their residences and the number of shares of stock owned by each, together with all essential facts regarding its

[28] Paton in *Proceedings of the National Tax Association,* vol. VII, p. 316.

[29] N. Y. Tax Law, secs. 13, 14, 23-26, 183, 188, 189, 191, 205.

capital, surplus, and undivided profits. Assessment is made by the assessors of the tax district. The shares are assessed to the owners in the tax district where the bank is located, regardless of the residence of the stockholders. The law provides that the value of each share shall be determined by adding the capital, surplus, and undivided profits and dividing by the number of shares. The rate is fixed in the statute at 1 per cent of this assessed value. Owners are entitled to no deduction for debts or other causes. The tax is in lieu of all other state and local taxes on the shares of stock and no state or local taxes are allowed upon the personal property of the banks. The tax is payable to the county treasury and is distributed to the various tax districts in proportion to their tax rates. In paying the tax the bank acts as the agent of the stockholders, from whom it is assumed to collect the amount paid. The bank has a lien upon shares of stock and any other property of the shareholders in its hands for reimbursement of taxes so paid. Real estate belonging to banks is subject to local taxation and no deduction from the value of the shares of stock is allowed on account of taxes on real estate. The rate of 1 per cent is assumed to be enough lower than the ordinary rates of the general property tax so that no injustice is caused by this additional taxation of real estate. This law has given general satisfaction.

New Jersey, after suffering for years under the defective system described above, has now a tax drawn on correct lines.[30] The new law is practically the same as the New York method except that the assessed value of real estate is deducted from the value of the shares and the rate is ¾ of 1 per cent.

Connecticut taxes banks and trust companies upon the market value of their shares of stock as determined by the state board of equalization.[31] The rate of the tax is fixed in the state law at 1 per cent. From the amount of the tax thus determined is deducted the tax paid on real estate in Connecticut. The tax is collected by the state and distributed to the towns in which the stockholders reside. The state retains the part paid on shares owned by persons residing outside the state except that in the case of a national bank the tax on shares owned by non-residents is paid to the town in which the bank is located, as is required by the federal statute. The principal defect in the Connecticut system is the market value basis of assessment. Connecticut has ex-

[30] Laws of 1914, ch. 90.

[31] Gen. Stat. sec. 2331, as amended by Acts 1903, ch. 204, Acts 1905, ch. 54; sec. 2332-2335.

perienced in the administration of this law most of the difficulties which have been mentioned above in connection with this basis.

Pennsylvania taxes the shares of bank stock under a state law administered by state officers.[32] The basis of valuation is the capital, surplus, and undivided profits. The tax is assessed as to the stockholders but is paid by the banks. Real estate is taxable locally. Banks have the option of paying at the rate of 4 mills upon the above value, or at the rate of 1 per cent on the par value of the stock alone. The tax is in lieu of all local taxation except taxes on real estate. The peculiarities of the Pennsylvania tax are the low rate and the optional feature. There appears to be no justification of the optional rate, and the normal 4-mill rate is about half of the tax paid by banks in other states where a uniform rate is fixed by law.

The state of California has had an interesting experience in the taxation of banks.[33] Until 1910 the state constitution required the taxation of all property in the state under a uniform rule. The law made banks taxable upon all of their property exactly like natural persons. This law was contrary to the provisions of the federal statute relating to the taxation of national banks. At first no serious difficulty resulted as there were very few national banks in the state. During the period from 1890 to 1896 several new national banks were established and a number of state banks went into the national system, the reason being primarily to evade state taxation, since they realized that as national banks they could not be taxed upon their property.

To correct this situation the legislature in 1899 provided for the taxation of shares of stock in national banks in conformity with the federal statute, but further allowing stockholders to make from the amount of their shares of bank stock all the deductions permitted by law to the holders of moneyed capital in the form of solvent credits. Deduction was also allowed for real estate taxed and for all property exempt by law from taxation. At first this system seemed to promise well. Very soon, however, the banks realized that under the deductions allowed they could generally show exemptions exceeding the value of the stock and thus escape taxation entirely. Still worse, the federal courts decided in 1905 that, since national banks were taxed upon their shares

[32] Act of July 15, 1897. (P.L. 292.)

[33] *Report of the Calif. Commission on Revenue and Taxation,* 1906, pp. 219-229. The entire chapter on Taxation of Banks in this report, pp. 219-253, is very valuable.

of stock and state banks upon their property, this involved a discrimination against national banks in favor of state banks. It was therefore held that the law was invalid for the taxation of national banks. From that time on national banks were not subject to any taxation whatever except upon their real estate. A few of the national banks, realizing this situation, voluntarily submitted to an assessment which they knew was not legally enforcible and paid a certain amount of taxes. Obviously such voluntary taxation was not sufficient to produce any large revenue nor to equalize the burden of taxation between state and national banks.

During all of this time the taxation of state banks also was unsatisfactory. They were taxable directly upon all their property in the same manner as individuals. Since, however, they were allowed to deduct debts, which included all of their deposits, the principal item of assets, loans and discounts, was very frequently wiped out entirely by the deduction of deposits. Various other items of the banks' assets were incapable of accurate assessment, and, finally, there was a great lack of uniformity in the practice of the local assessors. As a result, some banks practically escaped taxation entirely, others were severely penalized, and the whole system was marked by inequality, uncertainty, and injustice.

In 1905 the whole matter was referred to a special state tax commission. As a result of their recommendations the constitution was amended in 1910 allowing classification of property for purposes of taxation, and in 1911 the legislature enacted a law,[34] under which all shares of stock of banks are assessed and taxed to the owners by the state board of equalization in the town or city where the bank is located. The value of the shares of stock is the amount paid thereon plus a pro rata share of the surplus and undivided profits. The tax is in lieu of all other state and local taxes upon the shares of stock and upon the property of the banks except real estate, which is subject to local taxation like other real estate. From the value of the shares, determined as above, is deducted the assessed value of real estate. The remainder is the assessed value of the shares and is taxed annually at a uniform rate of 1.2 per cent. The tax is paid by the bank to the state in behalf of the stockholders. The bank has a lien upon the shares of stock and upon the dividends for reimbursement. With this law California has satisfactorily solved the problem.

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[34] Acts of 1911, ch. 335, secs. 1, 4, 12 and 18, as amended by Acts of June, 1913 and Jan. 28, 1915.